



PM's MONTHLY INSIGHT FUNDAMENTAL ACTIVE GROUP

Market Outlook and Investment Strategy

February 2019

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Japanese stocks are likely to remain sluggish in February. A steady rally in the US stock market is a positive factor. However, the latest earnings announcement of the October-December quarter is unlikely to support Japanese stocks. According to earnings reports by about a half of companies in terms of market capitalization which were disclosed by 1 February, recurring profits declined by 13% YoY. Although we have to take into consideration some one-off losses such as impairment losses due to the freeze on the UK nuclear power plant of a major electric equipment manufacturer, financial results were below expectations in general. Net income in total is likely to decline YoY in the latest quarter because a large amount of deferred tax liabilities was pulled out in the previous year following a tax reform in the US, which bloated net profits particularly in the automobile industry. Machinery and factory automation (FA) sectors are getting hit by a deceleration of economic growth in China. As the stocks had already been sold off, we may see a rebound in some of them despite lacklustre earnings. However, we do not expect the market to rally much further. With regard to China, a series of economic measures implemented by the government might start to bear fruit after the Lunar New Year. But unless the order intake from China increases at Japanese companies, we cannot expect a full-fledged rise in stock prices. Exporters who do not want to stand out will likely maintain conservative earnings forecasts, as it is still unclear when trade negotiations between Japan and the US will start.

Currently, Japanese equities are likely to be swayed by vagaries of economic statistics and political events without any confirmation of the recovery of fundamentals. Nonetheless, stock prices are unlikely to fall significantly with favourable economic indicators in the US and the stable exchange rate between USD and JPY. For the time being, stock prices will react to trade negotiations between the US and China as well as what the US will demand in trade negotiations with Japan.

That being said, the valuation of Japanese equities seems very low. The market had continued to factor in "the possibility of economic downturns in the future", reflecting leading economic indicators in 2018 despite the increasing earnings per share (EPS). The TOPIX's P/E ratio and dividend yields have fallen to record-low levels. Market expectations are assumed to be low as well.

The FOMC on 30 January removed the language "further step-by-step rate hikes are appropriate" from the forward guidance, which suggests a de facto cease of rate hikes for the time being. While we should not expect too much from US-China trade negotiations, which have a deadline set for 1 March, President Trump does seem to be leaning toward "a breakthrough of trade frictions with China" as the midterm election is over and stock prices plummeted on alert against negative impact of the trade war.

All in all, we believe stock prices suffered excessive declines, expecting adjustments of stock prices in a midterm horizon.

Investment Strategy

Overweight Sectors	Underweight Sectors
Automobiles & Transportation	Transportation & Logistics
Pharmaceutical	Machinery
Commercial & Wholesale Trade	Foods
Energy	Electric Appliances & Precision Instruments

We remain overweight in automobiles and IT & services, although we have narrowed the margin of overweight in automobiles due to their unpromising guidance. We will increase the weight in IT solutions following active investments in software development as well as increasing the weight of pharmaceuticals. On the other hand, we have reduced our weight in financials following a rebound.

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Mr Kamohara is the Lead Portfolio Manager of the Fundamental Active product. He started his career with Daiwa Securities in 1987 and transferred to Daiwa Institute of Research the following year to become a Japanese equity analyst. He was seconded to their Frankfurt office (between November 1992 and February 1995) and Hong Kong office (between February 1995 and March 1997) as an analyst for European and Asia equities respectively. He transferred to Daiwa International Capital Management, the former entity of Daiwa SB Investments, in 1998 to become a fund manager of international equities.

He became a Japanese equity portfolio manager in October 2000 and has managed the Fundamental Active product since its inception in October 2003.

Mr Kamohara graduated from Kyoto University with a BA degree in Educational Administration (1987).

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Mr Taniuchi supports Mr Kamohara in managing the Fundamental Active product. He started his career with Yamaichi Securities in 1996. He moved to Nikko Asset Management the following year as a trader of equities, convertible bonds and FX. He became a senior portfolio manager of Japanese equity specialising in Growth stocks. He joined Daiwa SB Investments in June 2008 to support Mr Kamohara in managing the Fundamental Active product.

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